



Zoom Video Communications, Inc. (ZM)

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RECOMMENDATION	/	PRICE TARGET	/	PRICE	/	VALUATION DATE	/	SECTOR
BUY		\$159.53 – \$170.03		\$155.40		5/12/2020		Software & Service

COMPANY DESCRIPTION

Zoom Video Communications, Inc. is one of the leading providers that engages in the provision of video-first communication platform. The easy, reliable, and innovative cloud-native unified communications platform provides frictionless video meetings, voice, webinars, and chat across desktops, phones, mobile devices, and conference room systems. Driving a rapid uptake across the enterprise landscape, the company has built a recognized market leadership and an efficient go-to-market engine that drives company's significant growth. Zoom focuses on customer and employee happiness and helps enterprises create elevated experiences with leading business app integrations and developer tools to create customized workflows. Founded by Eric S. Yuan in 2011, Zoom is headquartered in San Jose, California, with offices around the world.

Zoom at a Glance

Founded: 2011

IPO: 2019, under Nasdaq

Employees: 2500 (55% US-based, 45% international)

Company Milestones:

2013 – First public release of Zoom Meetings, which supported 200 million annual meeting minutes.

2019 – Exceeded 5 billion monthly meeting minutes.

REVENUE GENERATION

Zoom's 2019 Revenue

Zoom's total revenue from 2019 was reported at \$622.7 million which was an 88% increase from the total revenue in 2018 of \$330.5 million. Since the business was created in 2011, there has been steady growth in revenue each quarter and expect a high jump in the future due to COVID-19.

Revenue Drivers

- Zoom primarily generates subscription revenue through online messaging, calling, and video.
- Zoom has four different individual payment options which include the basic, pro, business, and enterprise plans. The basic plan is their free option that allows anyone to use but has member and time limit restrictions. The pro membership allows up to 100 participants with a 24-hour restriction and gives the user more access to other tools and controls. The business plan allows up to 10 people per membership and has everything the pro membership offers with a limit of 300 participants. The enterprise plan allows 100 people to be on one membership which allows unlimited cloud storage and can include up to 500 participants on each call.
- Other than the personal subscriptions, Zoom also offers the Zoom Phone, Zoom rooms, and video webinars. The Zoom phone is a single app for voice, video, messaging, and meetings. Zoom rooms is a video conferencing system for any sized conference which allows for people to screen share and communicate within participants. Lastly, Zoom also offers video webinars that can include 100 interactive video panelists, up to 10,000 attendees, and live Q/A.

INVESTMENT THESIS

Management

- Zoom's management team is a major factor when it comes to the success of the company.
- Eric Yuan has served as the Chairman of the Board, President, CEO, and Founder since June 11th, 2016. Before founding the company, Yuan graduated from Shandong University of Science and Technology with a bachelor's in mathematics and received a Master's in Engineering from the China University of Mining and Technology. Before founding Zoom, he worked as the Vice President of Engineering for Cisco's Systems Inc and Webex Inc.

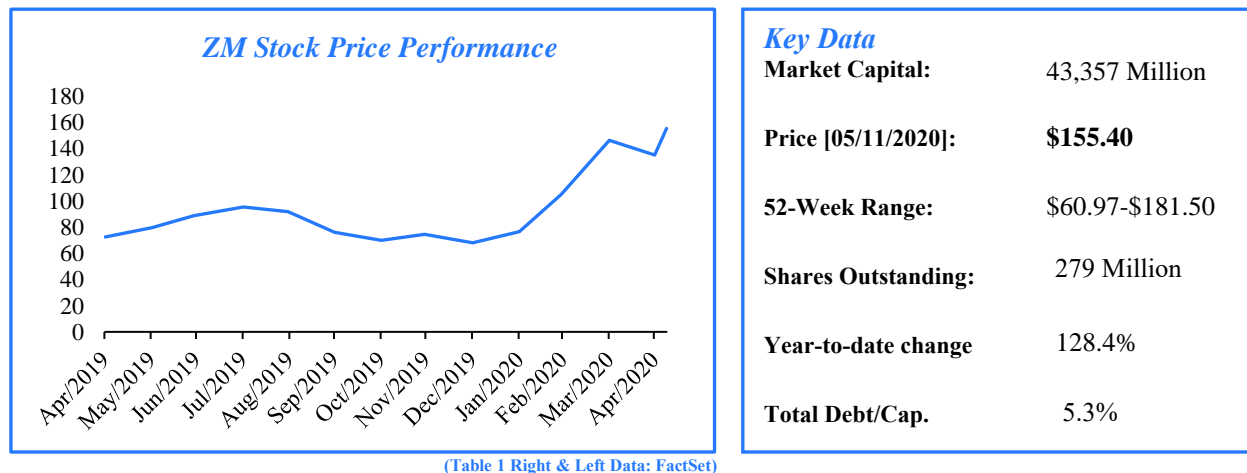
- Kelly Steckelberg has served as the Chief Financial Officer since November 2017. Similar to Yuan, Steckelberg has a solid track record of work experience prior to working at Zoom. She started with receiving a bachelors and master's in accounting at the University of Texas, then moved her way up from being Chief Financial Officer to Chief Executive Officer of the company Zoosk.
- Lastly, Janine Pelosi has worked as Zoom's Chief Marketing Officer since March 2019. Pelosi received her bachelor's in marketing at San Jose State University and worked as head of marketing and business at Zoom before being promoted to CMO.

Subscription Revenue

Zoom generates the majority of their revenue through subscriptions and other additional products and services. From December 31, 2019 to December 31, 2020, there was an 88% increase in total revenue. 63% of this revenue was from previous existing customers, while 37% included new customers. Since this was reported in December, there is expected to be a lot of newer customers since the outbreak of COVID-19. Analyzing subscription revenue is much easier for companies when looking into a recession. In a recession, Zoom will be able to see how many subscriptions they have at the beginning of the month and what to expect in future months. There are four different subscriptions that Zoom offers which include basic, pro, business, and enterprise. The basic subscription is free which allows users to host up to 100 participants with a 40-minute limit on group meetings. The pro subscription cost \$14.99/month which supports up to 100 users with a 24-hour limit. The business and enterprise subscription cost \$19.99/month which includes 300 and 500 participants with other accessible features. The Zoom Phone starts at \$10/month which is a single app for voice and messaging. Zoom Rooms is a video conferencing system available at any size for mass communications pricing at \$49/month. Lastly, Zoom's video webinar costs \$40/month and includes interactive video panelists, Q/A services, and live streaming to YouTube or Facebook.

STOCK PERFORMANCE

Zoom Video Communications started trading on April 18, 2019 and has done considerably well since opening. Since COVID – 19 began in December 2019, Zoom's stock price increased 135% with three-month change of 78.72%. In comparison with the S&P 500, Zoom continued to rise once the pandemic began while the S&P 500 dropped. Zoom's current trading price is at \$158.98 while the S&P's average is \$62.22.



BULL CASE ASSUMPTIONS

- Our bull case assumes a quickly remedied and overstated security concerns, which leads to regaining the customers who previously switched to other products.
- With the significant shift to "Work From Home" (WFH) capabilities, we expect a significantly better growth even post-COVID-19 as current and potential users experiencing Zoom's frictionless and outstanding technology during the outbreak of COVID-19 convert to long-term users/subscribers.
- Our upside scenario also is driven by high profitability from Zoom Phone cloud-native system, as it continues expansion into more international countries.

BASE CASE ASSUMPTIONS

- Our base case assumptions combine the consensus as well as published estimates and the staggering Meetings growth in usage. Explosion in users from a sticky core customer base including educations and healthcare, sales, etc. is likely to witness a sustainable COVID-19-driven increase and enlarging subscription.
- With the upside of COVID-19 responsive growth, we assume a downside effect caused by a slower increase and expansion of Zoom phone in the international markets.

BEAR CASE ASSUMPTIONS

- Our bear case is driven by COVID-19 decreases enterprise sales as well as the increasing customer churn caused by the continuing security and privacy concerns and more prohibition from other companies.
- Downside scenario includes lower growth rate compared with its historical rates post-COVID-19

RISK ANALYSIS

Limited operating history

Started corporation in 2011, Zoom has a limited operating history. With some uncertainties, Zoom's historical revenue growth might not provide an accurate base for forecasting the future movement. Company has expanded from \$61 million in FY17 revenue to over \$600 million revenue in FY20. It is outstanding in technical assessments by most industry analysts. Further, Zoom's future growth could slow for a number of reasons, including decreasing demand for our platform, failure to maintain a leading position among increased competition, and the rapid changing industry.

Interference with Users' Internet Access

Zoom's communication and collaboration services depend on users' high-speed broadband access to the internet. To achieve a high-quality experience on Zoom's platform through mobile devices, such as smartphones and tablets, requires a high-speed internet connection, such as 3G, 4G, LTE, satellite, or Wi-Fi, or in the coming years, the 5G. Increasing numbers of users and the usage without satisfying internet connection might affect the performance of Zoom's products.

Government Investigation involving Zoom or technology industry

Zoom is subject to both U.S. federal and international various laws, including those covering copyright, indecent content, child protection, consumer protection, telecommunications services, taxation, and similar matters. Precautions to prevent violations of these laws has been taken, but as Zoom continues to expand its international presence, once the exposure for violating these laws increases.

Cybersecurity & Privacy

The recent privacy and governance concerns about the default setting and inexperienced users has caused a considerable negative press releases and news around Zoom. The recent released media related o harassment and access control and usage has come from cases where users may not have been using the password protection or waiting room function that could have prevented these issues. This is an unpredicted and unfortunate downside when company focuses "too much" on ease of use vs. security & privacy.

RATIONALES: OUR WORDS ON FENCE

Recognizing and acknowledging risks Zoom might face with, we are yet encouraged by fundamentals and supportive facts. Knowing its relatively short operating history, high requirement of Internet condition, probing exposure to government investigation, and recent security issues, here are our rationales for pitching Zoom at this point:

- That said, we realize the relatively short operating basis Zoom has, but are encouraged by its enlarging customer subscription base (+86% Y/Y in FY20) and rapid incremental revenues in a high year-to-year growth rate (+88% y/y in FY20).
- We acknowledge Zoom's current and potential competitors' competitive advantages including larger capital investment, longer operating histories, more varied products. Nevertheless, we assess Zoom's high ability to compete effectively in the industry, based o its achievement of growing topline over 115% annually in the past three years, the recent introduction of Zoom Phone cloud system that enhances competition against similar products, and "It just works" frictionless video communication technology foundation.
- With the recent rapid growth of users during the outbreak of COVID-19, Zoom is planning to make additional investments in network capacity to maintain adequate data transmission speeds.
- Although the third-party network companies' deteriorations in their service might mislead the potential and current users to doubt Zoom's quality, we see the planning capacity spending from the company to meet the growth of user base and keep sufficiently high-data transmission speeds, reliability, or performance.

- The coming true end-to-end encryption in Zoom might bring some political risk, as it prevents ZM or any probing government/ law enforcement agencies from potentially seeing the meeting calls. However, current popular chat App WhatsApp does offer the same encryption and has survived the government scrutiny.
- While the security and privacy headwind is hard to quantify, we notice Zoom already fixed most, if not all, known as bugs and evaluate their R&D structure as part of this “90-day development hold period” to intently focus on improving security. Quick responses and actions taken including the new version of application with password protection and waiting rooms by default set, discontinuation of sharing non-essential data through Facebook software development kit (SDK). Zoom’s prompt responding, quick management adjusting, efficient system upgrading, and responsible actions benefits all users with the privacy and security improvement.

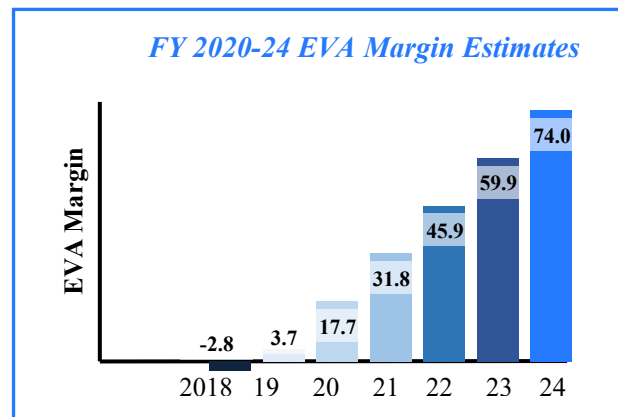
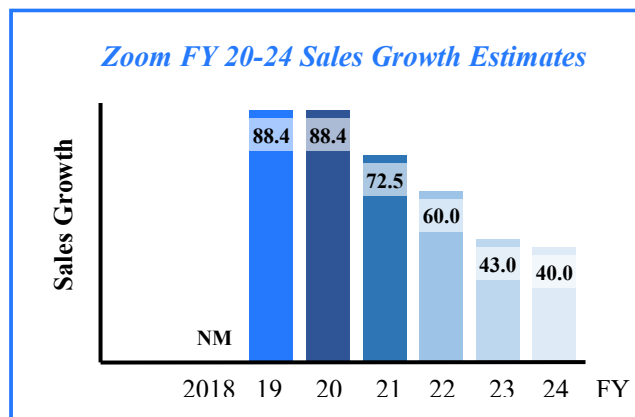
VALUATION

P/E Multiples Model

For the P/E multiples valuation, we looked at the average price per earnings ratio in each quarter of the past year. There was an average of 1,682.5 price/earnings and we multiplied that by Zooms earnings per share of \$0.09. This resulted in a target price of \$151.43.

EVA Projection Model

We adopt our bull case assumption into the EVA projection model, where we believe the company’s capability to generate revenue continuing a high growth rate. As the sales increased 88.4% during the FY20, we foresee a sustainable growth in sales later or post-COVID-19.



In our bull case, the EVA Income Statement Valuation gives us a target price of \$178 with a 15% upside versus market price of 155.40. In our base case, the EVA projection model reflects a base price of \$163 with a lower sales growth in FY 2024 estimation(36% in FY24 sales growth). The downside scenario that might be a hit from the headwind result in a \$126 bear case price that is -19% under the current trading price.

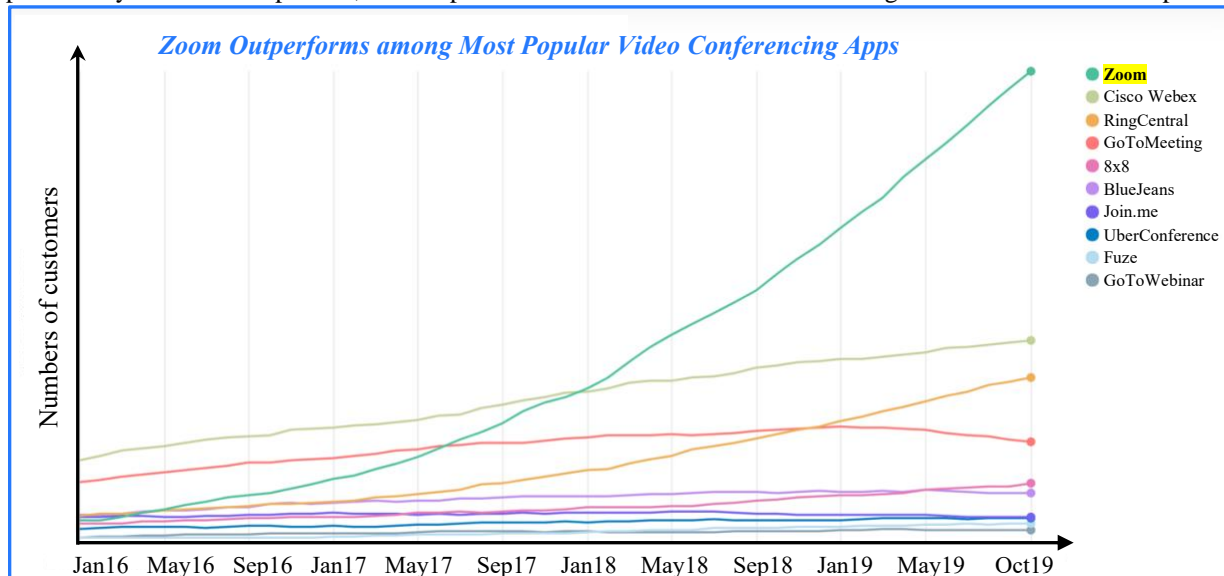
We chose a 70/30 weight to conclude our evaluation with 70% of EVA Projection Model and 30% of P/E Multiples Model, based on the rationales that our EVA model combines bull, base, and bear cases assumptions. It is appropriate to evaluate Zoom based on the forecasts on sales growth because of company’s limited operating history, counting sales incremental, and strong growth that was rarely achieved by sub-\$500M enterprises these days. In conclusion, we get a target price range of \$159.53 –\$170.03, with the bear-case price of \$133.629

PEER ANALYSIS

General Intensive Competition & A Leading Position

Within all current the United Communications & Collaboration (UC&C) field, there is a quickly changing and intensively competitive environment. At the forefront, Zoom’s existing competitors are legacy web-based meeting providers including Cisco Webex and LogMeIn GoToMeeting, bundled productivity solutions providers that allows video communication including Microsoft Teams and Google G Suite, and other products with communication and collaboration features such as BlueJeans, Join.me and so on. Additionally, large market capital companies like Amazon and Facebook have in the past and may enter the industry, which could increase competition.

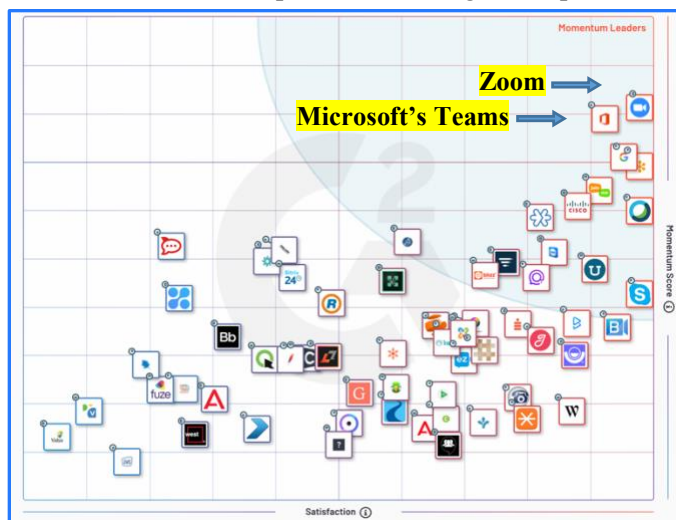
Surpassing a handful recognizable and direct competitors, Zoom now stands out as one of the leading providers in the videoconferencing space. Table 2 below shows Zoom's rapid enlarging customer base with a 876% growth over the past three years. For comparison, second-place Cisco Webex's customer numbers grew 91% over that same period.



(Table 2 Data: Okta BUSINESS @ WORK Report)

A Closer Look into Microsoft's Teams vs. Zoom

We take Microsoft's Teams as the peer company to analyze Zoom's competitive advantages. Reasonable comparison is made based on the increase usage in both Teams and Zoom exposed to COVID-19. While Microsoft Teams might have larger capacity investment and an easier access to customers through bundled Office 365 products, Zoom shows its successful penetration over the Microsoft's Team in both technology and customers activity. First, Zoom's usage has rocketed from 10 million daily meeting participants back in December to 300 million daily active participants this month. Rivals from Microsoft's Teams also claimed a smaller increase with 200 million meeting participants in a single day this month. Second, Zoom has already provided transport encryption, which reaches the same high security level as its competitors like Cisco's WebEx and Microsoft's Teams. In the foreseeable future, Zoom committed to providing true end-to-end encryption that could benefit all Zoom users with a higher level of security. Table 3 below shows Zoom's obvious competitive advantages compared with Microsoft's Teams.



(Momentum Grid Data Source: G2 Scoring)

As Zoom earns the highest momentum scores with high user satisfaction scores, employee growth, media presence, as well as increasing customers' reviews. Microsoft's Skype for Business earns the second highest satisfying score of 99, and Microsoft's Teams get the 7th place. This is consistent with Okta's "2020 Business @ Work Report" which shows that over 30% of Office 365 customers were using Zoom at the same time in 2019. Preference shown by Teams customers that do not use Teams for all video communications speaks loudly for Zoom's ease of use and doing business with, high quality of support, and high video functionality

OWNERSHIP SUMMARY

Investor Type in Zoom	%OS	Pos (000)
Total (Count: 546)	59.51%	75,857
Investment Adviser	29.00	36,965
Mutual Fund Manager	13.85	17,653
Hedge Fund Manager	5.52	7,035
Individual	4.96	6,326
Private Banking/Wealth Management	3.35	4,266
Venture Capital/Pvt Equity	1.14	1,458

(Table 4 Data: FactSet)

	Top Five and Other Noticeable Shareholders	%OS	% Port	Activism
1	Artisan Partners LP	5.64	1.30	High
2	Baillie Gifford & Co.	5.62	0.51	Low
3	Hillhouse Capital Advisors Ltd.	5.43	9.62	Very Low
4	Yuan Bin	3.88	100.00	-
5	Morgan Stanley Investment Management, Inc.	3.68	0.83	Very Low
6	The Vanguard Group, Inc.	3.04	0.00	Very Low
8	Salesforce Com, Inc. (Investment Management)	2.18	84.82	Very Low
17	Qualcomm, Inc.	0.78	29.27	-

(Table 4 Data: FactSet)

From Table 1 & 2 above, we notice a large ownership of shares in Zoom is held and preferred by investment advisers, mutual fund managers, and hedge fund managers. Within the top shareholders of Zoom, we notice companies from the technology sector including Salesforce Com, Inc. (a cloud-based software company) Investment Management and Qualcomm, Inc. (one of U.S. top semiconductors providers). Noticeably, Salesforce Com, Inc. Investment Management very inactively trades 2.18% of Zoom's shares as almost 85% of its portfolio. Maintaining a friendly investors' relationship with all shareholders meets Zoom's goal of making everyone happy.

RECOMMENDATION

We recommend a **BUY** for Zoom Video and Communications based on strong recent earnings and success during the COVID-19 pandemic. We expect Zoom's next earnings to be very high and to show major upside. Zoom went from 10 million daily usage in December to over 200 million in March once quarantine started. Zoom has had substantial growth in revenue in each quarter with no sign of downfall. Also, it has been used by many large enterprises including HSBC which has 290,000 active users, Johnson and Johnson with 60,000 active users, and Veeva has 3,000 employees using it. Ultimately, Zoom brings happiness to millions of people practicing social distancing to communicate with friends and family. We believe Zoom's stock will improve and continue to do well in the future.